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STAFF DIRECTOR

July 30, 2003

The Honorable William H. Donaldson
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Donaldson:

On July 23, 2003, the Committee on Financial Services favorably reported, by bipartisan voice vote, H.R. 2420, the Mutual Funds Integrity and Fee Transparency Act of 2003. As you know, this legislation includes numerous provisions directing the Commission to use its existing authority to take steps to help mutual fund investors. For example, the Committee believes that investors would benefit from Commission action that: (1) provides them with more intelligible and accessible information about the mutual fund fees they pay; (2) informs them and increases director scrutiny of potential conflicts of interest created by the use of certain distribution arrangements; (3) increases the transparency of sales practices that may create conflicts of interest by virtue of the payments brokers may receive for selling a particular fund or class of shares; and (4) strengthens the role of fund directors, and, in particular, independent directors.

We are pleased that you have asked the Commission staff to develop additional investor protection initiatives concerning the costs and conflicts of interest in mutual fund investments. We are also pleased that the Commission is focusing its examination resources on such conflict issues and that you anticipate that the Commission will consider additional regulation in this critical area of our markets in the near future. We believe these efforts will go a long way toward restoring the confidence of our Nation's 95 million investors who rely on mutual funds to help them achieve their financial goals.

To this end, we urge you to take these steps by using the Commission's existing regulatory authority to implement, as quickly as possible, those provisions of H.R. 2420 that do not require legislative action. In particular, the Commission should begin proceedings to issue rules, consistent with the interests of investors and competition in the capital markets, to accomplish the following:

1. Improve mutual fund fee and expense disclosures, per section 2(a) of the bill, including, specifically:
 - a. The estimated amount, in dollars for each \$1,000 of investment in the mutual fund company, of the operating expenses that are borne by shareholders;
 - b. A legend on investors' account statements explaining that they have paid fees on their fund investments;

- c. The structure of the fund's portfolio manager compensation;
 - d. Portfolio turnover rate, and description of implications of high turnover;
 - e. Information about the company's soft dollar and directed brokerage arrangements;
 - f. Information about the company's revenue sharing practices; and
 - g. Breakpoint discounts.
2. Improve board governance of soft dollar, directed brokerage, and revenue sharing arrangements, specifically:
 - a. Require adviser to submit an annual report to the board detailing soft dollar, directed brokerage, and revenue sharing arrangements;
 - b. Subject board to fiduciary duty to review such arrangements;
 - c. Provide investors with an annual summary of the report to the board; and
 - d. Require the portfolio manager to maintain certain records with respect to soft dollar arrangements.
3. Section 4 – Strengthen mutual fund governance by decreasing the maximum number of directors who may be “interested persons” from 60 percent to one-third of the board.
4. Section 7 – Clarify the use of the term “no-load” as used with respect to funds that charge a 12b-1 fee to prevent investors from being misled.
5. Section 8 – Require mutual funds to inform directors of significant deficiencies identified by the Commission.
6. Section 10 – Implement the proxy voting transparency rules that the Commission approved this year.
7. Section 11 – Improve mutual fund regulatory and ethics compliance by approving the Commission's rule proposal requiring funds to have a chief compliance officer, and by requiring that funds adopt a code of ethics.
8. Section 12 – Fight conflicts of interest in mutual fund sales practices by requiring brokers to disclose information about differential compensation and conflicts of interest associated with the broker's sale of a particular fund, along with information about commissions that may be charged based on the class of shares the investor has purchased

In addition, there are several matters that arose during the Committee's consideration of H.R. 2420 that we request the Commission to address by rulemaking or further study:

1. Please undertake the studies and concept releases included in the bill, and provide legislative recommendations where necessary:
 - a. Section 2(c) concept release examining improved disclosure of portfolio transaction costs;
 - b. Section 13 study of the use of soft dollar arrangements, including: The trends in soft dollar commission amounts; types of services provided; benefits and disadvantages of soft dollar arrangements for investors; issues relating to the potential or actual

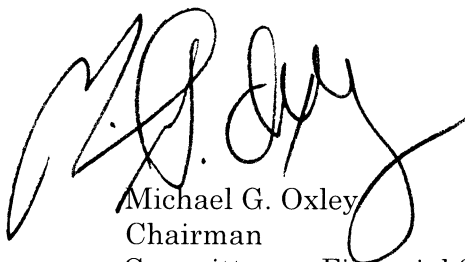
conflicts of interest created by soft dollar arrangements; transparency of these arrangements; and whether section 28(e) of the Exchange Act of 1934 should be modified; and

- c. Section 14 study of increased rate of arbitration claims involving mutual funds to identify trends and potential causes.
2. In addition, Committee Members noted at the Committee markup of H.R. 2420, during the discussion of the legislation's provision regarding mutual fund boards of directors, that mutual funds should not be treated differently from other companies. In this regard, we note that the Commission staff has just completed a report discussing alternatives for increasing shareholder participation in the proxy process regarding the nomination and election of directors, which we understand may form the basis for a rulemaking proposal in the near future. Please indicate what steps the Commission or staff intends to take to ensure that mutual fund shareholders are given the same rights as other corporate shareholders pursuant to this expected rulemaking.

We would appreciate a report from the Commission by October 1 on the progress the Commission has made, and what steps the Commission plans to take, to effectuate the items enumerated above.

We applaud the Commission's efforts to protect mutual fund investors and look forward to working with you to ensure that the measures that the Committee approved are implemented as soon as possible.

Yours truly,



Michael G. Oxley
Chairman
Committee on Financial Services



Richard H. Baker
Chairman
Subcommittee on Capital
Markets, Insurance, and
Government Sponsored
Enterprises

cc: The Honorable Barney Frank, Ranking Member
Committee on Financial Services

The Honorable Paul E. Kanjorski, Ranking Member
Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises